TAX-EXEMPT BOND FINANCING & AN OVERVIEW OF THE CALIFORNIA DEBT LIMIT ALLOCATION COMMITTEE (CDLAC)

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Agenda

- Overview of Bonds
- CDLAC Structure
- CDLAC Programs & Processes
- Accessing the Capital Markets

BONDS

What Are Tax-Exempt Bonds?

- Bonds are a form of debt.
- When investors purchase bonds, they essentially lend money to the bond seller, or issuer. In this way, a bond is similar to an IOU. In return for the bond proceeds, the issuer promises to pay the investor a specified rate of interest over the life of the bond and to repay the bond when it comes due.
- Government agencies sell bonds to finance a variety of projects and activities. Corporations may also sell bonds to finance projects and/or capital expenditures.
- Governments *typically* issue tax-exempt bonds; Corporations *typically* issue taxable bonds.

Municipal Bonds

- Bonds issued by government agencies are called municipal bonds.
- The funds are used to finance projects that benefit the community such as roads, schools, bridges, sewers, parks, water treatment or low-income housing. Most bonds issued by government agencies are tax-exempt, **as defined under the Internal Revenue Code**. This means bondholders do not have to pay federal income taxes and, in most cases, state income taxes on the interest they earn.
- In addition to the tax-exempt status, investors benefit from the taxing authority of the government agencies. That authority strengthens the security of municipal bonds, giving investors greater assurance they will get paid on time and in full.
- The tax-exempt status and minimal risk of default lead investors to agree to lower interest rates relative to other forms of borrowing. As such, government agencies, and thus the taxpayers, can benefit from lower borrowing costs as compared to standard market loans or even taxable bonds.

Private Activity Bonds

- Government agencies may also, in certain cases, issue tax-exempt bonds on behalf of private businesses.

- These bonds are known as "Qualified Private Activity Bonds" and may be issued for various purposes such as low income multi-family housing, industrial development, redevelopment projects, enterprise zones or facilities that treat water, sewage or hazardous materials. The lower borrowing costs facilitate the development of projects that may not otherwise be feasible if financed at market rates.

- Unlike typical municipal bonds, the payment of principal and interest on private activity bonds is not the responsibility of the issuing government agency. Instead, it is the responsibility of the private business receiving the proceeds. By relieving government agencies of the financial obligations associated with bond debt, private activity bonds are a low-risk alternative for communities to finance projects.

CDLAC

California Debt Limit Allocation Committee (CDLAC)

The California Debt Limit Allocation Committee (CDLAC) is a three member Committee comprised of the State Treasurer as Chair, the Governor, and the State Controller.

CDLAC was created in 1986 by Governor Proclamation in response to the 1986 Tax Reform Act, which imposed an annual limit on the dollar amount of tax-exempt private activity bonds that may be issued in a state. Private activity bonds include multifamily and single family housing bonds, student loan, exempt facility bonds and industrial development bonds. The Act also required each state to designate an entity to allocate the state's ceiling among various state and local issuers. In California CDLAC is that entity.

The Committee has three non-voting advisory members, the Director of the Department of Housing & Community Development, the Executive Director of the California Housing Finance Agency, and a local government representative appointed by the Chair of the Committee.

Statutory Responsibilities

State: The California Debt Limit Allocation Committee (Committee) was statutorily created in California by Chapter 943, Statutes of 1987, in response to the 1986 Federal Tax Reform Act. California Government Code Section 8869.80 et seq. defines the Committee's responsibilities as follows:

- Set the Annual State Ceiling: The Committee is required to establish the California allocation limit for private activity bonds (the CAP). The CAP is established as soon as is practicable after the start of each calendar year. Historically, the Committee has set the annual CAP in January, and has used the "per capita" formula as prescribed by the U.S. Treasury. For example, the 2010 cap was set at $3,326,549,760. The 2011 CAP is based on the December 2010 population estimate of 37,253,956 (37,253,956 x $95 = **$3,539,125,820**).

- Allocate the State Ceiling: The California Debt Limit Allocation Committee is granted the sole authority for allocating the annual CAP in California.

- Other Administrative Functions: CDLAC is a fee financed agency which is authorized to prepare forms, establish procedures and regulations, set priorities, require a performance deposit, assess fees, and perform other administrative functions as necessary.

CDLAC Programs

CDLAC is a fee based program and receives no federal or state funding. Agencies and organizations authorized to issue tax-exempt private activity bonds or mortgage credit certificates must receive an allocation from CDLAC. The bonds issued utilizing the private activity bond allocation are purchased by municipal bond investors and the repayment is the obligation of the Borrower not the state.

CDLAC has adopted Regulations for allocating the annual state ceiling. The Regulations give priority to projects or programs that provide the greatest public benefits. Applications for award of allocation are reviewed and recommended through a competitive process.

The Committee has six (6) program pools for the issuance of tax-exempt private activity bonds:

- Qualified Residential Rental Program (QRRP)
- Single-Family Housing Program
- Teacher Extra-Credit Home Purchase Assistance Program
- Student Loan Program
- Small-Issue Industrial Development Bond Program
- Exempt Facilities Program

Qualified Residential Rental Program (Multifamily)

State and local governmental agencies and joint powers authorities can issue tax-exempt housing revenue bonds. These bonds assist developers of multifamily rental housing units to acquire land and construct new units or purchase and rehabilitate existing units. The tax-exempt bonds lower the interest rate paid by the developers. The developers in turn produce market rate, mixed-income, and affordable rental housing for low and very low-income households by reducing rental rates to these individuals and families. Projects that receive an award of bond authority have the right to apply for non-competitive 4% tax credits.

Bond Authority for Rental Projects is awarded to three sub-pools:

- General Pool (Projects having more than 50% of total units designated as Restricted Rental Units);
- Mixed Income Pool (Projects having 50% or fewer of total units designated as Restricted Rental Units);
- Rural Project Pool (Projects located in a rural area as defined by California Health and Safety Code Section 50199.21 but shall not include a Mixed Income Project).

Single-Family Housing Program

State and local governmental agencies and joint powers authorities can issue tax-exempt mortgage revenue bonds (MRBs) or mortgage credit certificates (MCCs) to assist first-time homebuyers to purchase homes. These agencies and authorities may issue MRBs, the proceeds of which back below market interest rate mortgages. As an alternative to issuing MRBs, state and local governmental agencies and joint powers authorities may issue MCCs. Homebuyers use the MCC to reduce their federal tax liability by applying the credit to their net tax due. Homebuyers may purchase single-family homes, either free-standing detached, condominiums or townhouses. Program participants must meet program income limits and must purchase a home that falls within the program's purchase price limitations.

Single-Family Housing Program (Cont.)

Extra Credit Teacher Home Purchase Program

Participants must be employed at a High Priority school and make a commitment to work at a High Priority school for at least three years. In addition, Program participants must meet program income limits and must purchase a home that falls within the program's purchase price limitations.

CalHFA, the state administer, has suspended the ECTHP program due to a freeze in bond funded Proposition programs. The ECTP offered a combination of a first mortgage funded with tax exempt bond proceeds and a subordinate loan funded with Proposition 46 funds. Proposition 46 proceeds have been exhausted and it is unknown when additional funds will become available.

Small Issue Industrial Development Bond Program (IDB's)

Small-Issue Industrial Development Bonds (IDBs) are tax-exempt private activity bonds that are issued through state and local governmental agencies to assist manufacturing facilities finance capital expenditures. IDBs support expansions of existing manufacturing companies. IDBs offer interest rate savings to small and midsize manufacturers in contrast to conventional loans. When used by manufacturers, IDBs serve to create new jobs and retain existing jobs within their communities.

Exempt Facility Program

Exempt Facility Bonds are tax-exempt private activity bonds that are issued by state and local governmental agencies to finance a variety of community serving facilities; solid waste disposal and waste recycling facilities among them. The tax-exempt bonds provide facility owners with low cost financing in the form of below market interest rate loans. The interest rate savings enable the project owners to maintain lower customer rates or minimize customer rate increases, while at the same time assisting the communities they serve to meet their mandated requirements to protect and enhance the environment. Exempt facility projects also benefit the communities by creating new jobs.

Student Loan Program

Student Loan Bonds are tax-exempt private activity bonds issued by authorized agencies for the purpose of either financing direct loans to college students and their parents or purchasing bundles of already-originated loans on the secondary market. When used for direct lending programs, tax-exempt bond allocation allows lenders to pass on interest rate savings to “needy” students through below market interest rate loans. Needy students are borrowers for whom the cost to attend college exceeds their ability to pay, as determined by their school's financial aid office. Currently, three agencies are authorized to issue tax-exempt bonds for student loan programs in California: ALL Student Loan Corporation, Educational Funding Services, Inc. (EFSI) and the California Educational Facilities Authority.

The HIRE Act of 2010 de-authorized the federal government’s student loan insurance program; a key credit enhancement source for the sale of these bonds. Though it is still possible, the likelihood of any further student loan-backed private activity bond issuance is extremely remote.

AMERICAN RECOVERY AND REINVESTMENT ACT (ARRA) PROGRAMS

On February 17, 2009 the ARRA was enacted. Following this enactment, CDLAC was designated, by statute, as the state entity responsible for the reallocation of **Recovery Zone Economic Development Bond**, **Recovery Zone Facility Bond**, and **Qualified Energy Conservation Bond** issuance authority initially provided to local governments by the U.S. Treasury.

To the extent a local government in receipt of a U.S. Treasury direct allocation did not intend to issue bonds within the established CDLAC timeframes, CDLAC then reallocated its authority to other issuers throughout the state for qualifying projects through a competitive application process.

Federal authority for the two Recovery Zone Bond programs expired on December 31, 2010. The Qualified Energy Conservation Bond program has no sunset date; however, no uncommitted allocation remains in California and no new allocation has been provided by the federal government.

Recovery Zone & QECB Activity

- As of August 15th, the State received 'back' the following unused amounts from the Localities:
  - $856MM for RZFBs (out of $1.2Bln for CA)
  - $268MM for RZEDBs (out of $806MM for CA)
  - $249MM for QECBs (out of $381MM for CA)

- As of December 31st, CDLAC awards to projects totaled:
  - $471MM for RZFBs (55% of $856MM available)
  - $262MM for RZEDBs (98% of $268MM available)
  - $239MM for QECBs (96% of $249MM available)

- Surprising number of Renewable Energy-related projects in all programs

- Some unrated transactions, but only a few successfully closed

PROGRAM OPERATIONS

Roles and Responsibilities

CRITICAL CALENDAR DATES

Public Allocation Meetings: The Committee conducts its business in a public meeting forum. The Committee meets as soon as practicable after the beginning of each calendar year, and before any Applications are considered, the Committee determines and announces the establishment of either an open application process or an allocation round process or both. The Committee will determine which process is best for each program based on the estimated competition and characteristics of each pool.

If the Committee estimates that a program pool will be non-competitive or evenly subscribed, then the Committee shall establish an open application process. If the Committee estimates that the program pool will be competitive, or over subscribed, then the Committee shall establish an allocation round process.

For 2011, the Committee met in January to set the 2011 state ceiling and announce the 2011 program reservations. Since 2005, the Committee has scheduled allocation meetings according to the demand of the program pools. With the exception of the Student Loan and Exempt Facility programs, all programs have been undersubscribed allowing the Committee to make most allocation meetings available to all Applicants. The California Debt Limit Allocation Committee has approved an open application process for 2011, with allocation meetings to be held in **January, March, May, July, September and December of 2011.**

CDLAC Applicants (Issuers)

A CDLAC applicant is any state or local governmental agency, joint powers authority (JPA), special district, non-profit public benefit corporation or any other public agency that is empowered to issue debt. Issuing Authorities include, but are not limited to the following: California Housing Finance Agency (CalHFA), California Statewide Communities Development Authority (CSCDA), Association of Bay Area Governments (ABAG) and California Municipal Finance Authority (CMFA). In addition, high volume local governmental applicants include City of Los Angeles, Housing Authority of the City of San Diego, Housing Authority of Sacramento, City of San Jose, CRA of Los Angeles, County of Contra Costa, and City and County of San Francisco.

2011 Goals & Objectives

- <u>Allocate fairly to programs/projects with the highest public benefits</u>: In California the Legislature has established lower income housing for families and individuals as the highest public benefit priority.

  Past year results: The 2010 allocations are expected to provide the following public benefits:
  - Assist approximately 2,392 low to moderate income first-time homebuyers.
  - Finance the development of 6,399 multifamily rental units, of which 5,262 units are reserved for very low income households.
  - Create an estimated 435 new manufacturing jobs in California.
  - Financed eleven (11) solid waste disposal facilities.

- <u>Complete enactment of Permanent Regulations:</u> Formalizing CDLACs governing , operational, and programmatic rules to ensure both consistency with our stated public policy goals and transparency to all stakeholders who seek to access to our programs.

2011 Goals & Objectives

- **Improve & Update CDLAC Operations:** CDLAC will implement some measures to increase efficiency and the staff knowledge base:
  - Update the (Internal) Operations Manual
  - Update the Application Staff Report Template
  - Secure Refresher/Update Training for the Staff

- **Facilitating Project Activity:** CDLAC also pursues initiatives designed to support development and program activity in each of the six CDLAC allocation programs
  - **Housing:**
    - New Issue Bond Program
    - FHA Coordination
    - PUC Relationship
  - **Exempt Facility:**
    - Water Resources (w/CPCFA)

ACCESSING THE MARKETS

Where to Begin

- Selecting Your Issuer
  - Location (Eligibility)
  - Familiarity with your Project Type
  - Fees
  - Prevailing Wage

- Building Your Financing Team
  - Bond Counsel
  - Financial Advisor
  - Placement Agent / Underwriter
  - Lender
  - ***Build your team based upon the best bond structure for your project!***

- Follow a Realistic Timeline
  - Readiness = Dollar Savings!

Observations on Accessing Capital – Public Sales

- Conduit Bond public sales will remain sensitive to the fluctuations in the Muni markets in general, but targeted marketing by Placement Agents can mitigate the impact on pricing for the issuance.
- Credit providers and bond investors have moved toward a true risk-based underwriting posture.
- Credit Enhancement, particularly for private activity bonds, will remain scarce for the foreseeable future.
- However, placement agents have been successful in moving mid- to low-investment grade issuances, suggesting that the markets have adjusted to a more diversified bond supply. Yet, pricing on these has remained very fluid.
- Credit rating agencies are recalibrating their municipal bond rating scales; will reassess conduit financing issuers as well.

Observations on Accessing Capital – Private Placements

- Private Placements and Invitation-Only QIB Sales have proven to be viable alternatives to public sales.

- Private Placements are being driven by the CRA-credit needs of the commercial banks, and special governmental initiatives such as the New Issue Bond Program.

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